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DEC 2 2 2003

Federal Communications Commission
Office of Secretary

December 22, 2003

Marlene H Dortch
Secretary
Federal Communications Commission
445 12th Street, S W
Washington, D C 20554

Re *In the Matter of Section 272(b)(1)'s "Operate Independently" Requirement for Section 272 Affiliates*
WC Docket No 03-228
REDACTED – FOR PUBLIC INSPECTION

Dear Ms. Dortch

Enclosed for filing on behalf of the Verizon Telephone and Long Distance Companies ("Verizon") in the above referenced matter are two copies of the public version of Verizon's reply comments The original and a copy of the proprietary version of Verizon's reply comments are being submitted under a separate cover letter. I am also providing an additional copy to be file-stamped and returned to me

Pursuant to the bureau's Protective Order released December 19, 2003, Verizon requests confidential treatment of certain data contained in the proprietary version Verizon's reply comments

Should there be any questions, please contact me at 202-663-6455

Respectfully submitted,

Lynn R. Charytan

Lynn R. Charytan

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Enclosures

cc Janice M Myles

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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Federal Communications Commission
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In the Matter of	)	
	)	
Section 272(b)(1)'s "Operate Independently"	)	
Requirement for Section 272 Affiliates	)	WC Docket No. 03-228
	)	

REPLY COMMENTS OF
THE VERIZON TELEPHONE AND LONG DISTANCE COMPANIES

FOR PUBLIC INSPECTION

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December 22, 2003

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Summary

The Commission plainly has authority to reconsider the balance it originally struck when it imposed the operating, installation, and maintenance ("OI&M") sharing prohibition. Neither the text of 272(b)(1) nor the Commission's prior decisions constrain that authority in the least. The contentions of the long distance carriers in their comments are quite simply wrong.

Moreover, the record overwhelmingly demonstrates that the OI&M rule *should* be eliminated as a matter of sound policy. Nothing offered by the long distance carriers undermines the case for lifting the restriction. The rule serves no purpose and merely adds cost and impedes efficiency. First, events since 1997 have mooted whatever concerns may have existed about the BOCs' incentives to discriminate or misallocate costs The growth of competition across all segments of the market, changes in the price caps regime, and adoption of the CALLS plan have eliminated such incentives by ensuring that misallocations can have no practical impact on rates for regulated services. Second, other proven and sufficient safeguards, already in place, also preclude opportunities for improper cost allocation and discrimination and would facilitate their ready detection. Thus, the OI&M restriction is "overbroad" to address any possible remaining concerns.[1/]

At the same time, the restriction imposes inefficiencies on and increases costs for the BOCs' broadband deployment, an already investment-intensive endeavor The obligation to comply with the OI&M requirements, and thus to incur costs to duplicate personnel and services, burdens the BOCs' ability to compete effectively with their more established cable and

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1/ Notice of Proposed Rulemaking, *Section 272(b)(1)'s "Operate Independently" Requirement for Section 272 Affiliates*, WC Docket No. 03-228, FCC 03-272 at 12, Separate Statement of Commissioner Martin (rel Nov 4, 2003) ("NPRM").

interexchange company competitors and runs directly counter to the Commission's expressed interest in encouraging a robustly competitive broadband market. Indeed, Verizon has already incurred **[BEGIN PROPRIETARY]** **[END PROPRIETARY]** in costs attributable to the OI&M restriction and estimates that it could avoid $183 million over the next few years if the OI&M restriction were eliminated.[2/]

For all these reasons, the Commission should promptly eliminate the OI&M restriction.

I. Section 272(b)(1) Does Not Require the OI&M Sharing Prohibition, and the Commission Plainly Has Authority To Eliminate That Restriction.

It is beyond question that the Commission may revisit and eliminate the OI&M rule.[3/] As the D C Circuit has held repeatedly, an agency is not permanently foreclosed from revisiting prior interpretations of a statute, the rule is simply that "in changing its course of policy, [the] agency [must] indicate that prior policies are being expressly changed and not casually ignored." *Thomas Radio Co. v. FCC*, 716 F.2d 921, 924 (D.C Cir. 1983). And, of course, the premise of this proceeding is the Commission's express recognition that a change in its prior interpretation is warranted.

The long distance carriers argue that the Commission *is* foreclosed in this case from revisiting its prior interpretation because the OI&M rule is a statutory requirement -- rather than

[2/] *See* Letter from Dee May, Assistant Vice President, Federal Regulatory, Verizon, to Marlene H Dortch, Secretary, FCC, CC Docket No. 96-149, at Attach. 4 (filed June 4, 2003) ("June 4 2003 Ex Parte"); *id.* at Attach. 3 at 6.

[3/] AT&T's contention that the D.C. Circuit's holding in *ASCENT v. FCC*, 235 F.3d 662 (D.C Cir. 2001) (amended by *ASCENT v. FCC*, 2001 U.S. App. Lexis 1499 (D.C Cir. Jan. 18, 2001)), precludes the FCC from revisiting the OI&M rule here because it concluded it could not forbear from that rule is simply fallacious *See* Comments of AT&T Corp., Dec. 10, 2003, at 29-30 ("AT&T Comments"). Notwithstanding AT&T's artful quoting, the *ASCENT* holding addresses the merits of the particular statutory interpretation at issue in that case and does not even suggest that the Commission is precluded from exercising its authority to revisit rules and refine its statutory interpretations.

the discretionary policy judgment that it is -- and that no other interpretation is possible. Indeed, AT&T goes so far as to argue that the Commission, by revisiting its interpretation of section 272(b)(1), is seeking to "circumvent the limits on its authority" and "violate the Act."[4/] But the long distance carriers' theory is simply wrong. As Commissioner Abernathy has succinctly explained:

> There is little doubt that the OI&M restriction falls into the category of rules that are not "requirements" of the statute. When the Commission adopted the ban on sharing OI&M functions, it acknowledged that — unlike some of the other safeguards it was adopting — this rule was not compelled by the text of section 272.[5/]

As a preliminary matter, the Commission need never have adopted the OI&M restriction or *any* other distinct requirement under section 272(b)(1) at all. In crafting section 272, Congress deliberately chose specific requirements to ensure operational independence. Congress could have imposed other requirements, such as the OI&M and joint ownership prohibitions, but it did not. By contrast, it expressly included those precise restrictions in the Act's provisions concerning electronic publishing. *See* 47 U.S.C. §§ 274(b)(7)(1)-(9). Section 272(b)(1)'s "operate independently" language was not an invitation for the Commission to make that judgment anew. Indeed, the Commission previously has implemented "operate independently" without suggesting it required specific obligations: in interpreting section 274(b), the Commission merely reiterated that the affiliate "operate independently" in its implementing

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4/ *See* AT&T Comments at 30.

5/ *See* Memorandum Opinion and Order, *Petition of Verizon for Forbearance from the Prohibition of Sharing Operating, Installation, and Maintenance Functions Under Section 53.203(a)(2) of the Commission's Rules*, CC Docket No. 96-149, FCC 03-271, Dissenting Statement of Commissioner Abernathy at 9 (rel. Nov. 4, 2003) ("Forbearance Order").

regulations in addition to meeting the requirements Congress itemized. *See* 47 C.F.R. § 64 702(c)(2) (enhanced services).[6]

Even if, however, section 272(b)(1) *does* impose distinct regulatory obligations above and beyond those in sections 272(b)(2)-(5), it does *not* require the OI&M rule in particular. The long distance carriers contend that the Act does require the OI&M rule because it *precludes* integration entirely For example, AT&T argues that the OI&M rule is required because Congress intentionally chose to enforce protections "that will necessarily lead to efficiency losses due to lack of integration[.]" *See* AT&T Comments, at 11.[7]

But the Act neither expressly nor implicitly precludes all integration or sharing between BOCs and their section 272 affiliates. To the contrary, the Commission understood that Congress sought to *permit* integration, while simultaneously guarding against the risk of discrimination and cross-subsidization after a BOC initially obtains section 272 relief. As the Commission found, Congress recognized that it would be in the public interest to provide consumers with "the ability to purchase local, intraLATA, and interLATA telecommunications services, as well as wireless, information, and other services, from a single provider (i.e., 'one-stop shopping'), and *other advantages of vertical integration.*"[8] "[T]he purpose of the operate

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[6] Further, section 272(b)(1)'s goal of operational independence is advanced by application of other, existing Commission rules, such as the Commission's cost allocation rules that are applicable outside of section 272. 47 C F.R. § 32.27

[7] *See also* Comments of MCI. Dec. 10, 2003, at 5 ("MCI Comments") (arguing that permitting the sharing of OI&M services must be prohibited because that would permit the BOC and its affiliate to achieve integration that would "avoid the need for . . . handoffs and coordination").

[8] First Report and Order and Further Notice of Proposed Rulemaking, *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, As Amended*, 11 FCC Rcd 21905, 21911 ¶ 7 (1996) ("*Non-Accounting Safeguards Order*") (emphasis added); *see also* Third Order on Reconsideration, *Implementation of the Non-*

independently requirement is not to separate local and long-distance operations, per se." *Non-Accounting Safeguards Reconsideration Order* at 22. While a complete ban on all integration -- including all shared services -- might serve the interests of the *long distance carriers* by artificially improving their competitive outlook, it would not serve consumers or the public interest in robust competition, and it is not required by the Act. Indeed, the Commission specifically "decline[d] to read the 'operate independently' requirement to impose a prohibition on all shared services[.]" *Non-Accounting Safeguards Order* at 21986 ¶ 168, and found that the structure of section 272 specifically "suggest[s] that Congress envisioned the sharing" of services between the BOCs and their section 272 affiliates. *Non-Accounting Safeguards Reconsideration Order* at 16313 ¶ 18. If Congress had *not* intended BOCs and their section 272 affiliates to share services, it certainly would have had no reason to enact section 272(c), which bars the BOCs from discriminating between their affiliates and other carriers with respect to the services the BOCs provide

Nor is there any merit to the long distance carriers' argument that section 272(b)(1)'s "operate independently" requirement *specifically* required a ban on the sharing of OI&M services Their focus on the use of the word "operate" in both the statutory provision and the category of services at issue is mere semantic game play. *See* AT&T Comments, at 12; MCI Comments, at 2-5 Carriers can "operate" independently even if they share employees that perform OI&M services -- especially (though not exclusively) where, as here, they own and operate independent switches If it were otherwise, many telecommunications carriers would be

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Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, As Amended, 14 FCC Rcd 16299, 16313 ¶ 18 (1999) ("*Non-Accounting Safeguards Reconsideration Order*") (noting that integration of the services between BOCs and their section 272 affiliates can provide "economic benefits to consumers").

surprised to learn that they are not "operating" independently because they do not own all their own facilities and/or outsource or share some OI&M services. CLECs, for example -- including those operated by AT&T and MCI -- presumably believe they operate independently despite being *wholly* dependent upon unbundled network elements and the incumbent's performance of maintenance and other service: many employ nothing more than marketing personnel, yet clearly "operate independently" from the incumbent. Similarly, long distance resellers operate independently despite being dependent on the facilities and services of others. Certainly, then, a section 272 affiliate certainly may share its services with a BOC and still operate independently.

And the Commission already has rejected the long distance carriers' contention that section 274 of the Act requires the adoption of the OI&M prohibition under section 272. *See* AT&T Comments, at 12-13, n. 8, MCI Comments, at 3. The Commission concluded that "structural differences in the two sections indicate that the term 'operate independently' in section 272(b)(1) 'should *not* be interpreted to impose the same obligations' as the enumerated requirements in sections 274(b)(1)-(9)." *Non-Accounting Safeguards Reconsideration Order* at 16311-12 ¶ 16. Since many of the enumerated requirements in section 274(b) overlap with those enumerated in section 272(b)(2)-(5), the Commission found that interpreting section 272(b)(1) to require all the protections in section 274(b) would render the rest of section 272(b) a nullity. *Id.* Further, if section 274(b) is relevant at all, it shows that where Congress intended to prohibit sharing of OI&M services, it was quite capable of saying so directly.

As the Commission found, even if the operate independently requirement had to be implemented through specific protections, it clearly "compel[led] . . . [no] particular set of restrictions." *Non-Accounting Safeguards Reconsideration Order* at 16310 ¶ 14. The Commission's decision to adopt the OI&M rule was, in Commissioner Abernathy's words, "a policy judgment" that an outright prohibition on sharing these services would best serve the careful balance Congress sought to achieve in section 272 between permitting the economies of integration and safeguarding against discrimination and cost misallocation. *See Forbearance Order*, Dissenting Statement of Commissioner Abernathy; *Non-Accounting Safeguards Order* at 21984 ¶ 163. As we show below, and as the record in this proceeding amply demonstrates, regulatory and competitive developments since the rule's adoption, as well as the magnitude of the competitive burdens the rule has imposed in practice, warrant a different outcome today. The Commission has "wide latitude" to change its policies to respond to "[t]echnological, commercial, and societal aspects of the industry[,]" *Committee for Effective Cellular Rules v. FCC*, 53 F.3d 1309, 1317 (D.C. Cir. 1995) (citations omitted), *Harrington v. Chao*, 280 F.3d 50, 59 (1st Cir. 2002) ("[a]gencies . . . have leeway to change their interpretations of laws."). Indeed, the Commission has regularly revisited separation requirements similar to the OI&M restriction to determine whether its initial analysis of the competing costs and benefits still holds, and it has repeatedly eliminated its earlier restrictions.[9/] It can and should do so here.

II. The Record Shows That the OI&M Restriction Serves No Purpose.

The OI&M restriction is unnecessary given competitive developments, the elimination of any incentives to misallocate costs, and the presence of other more effective and less costly safeguards. AT&T, MCI, and Sprint have failed to come to grips with these changed circumstances, but it is plain to all but them that the world today is not just as it was in 1996.

9/ In the *Computer Inquiries*, for example, the Commission remarked that it would "reexamine the public interest ramifications and regulatory implications" of structural separation if it received evidence of serious inefficiencies. Final Decision, *Amendment of Section 64.702 of the Commission's Rules and Regulations*, 77 F.C.C 2d 384, 422 (1980) ("*Computer II*"); *see also* Report and Order, *Amendment of Sections 64.702 of the Commission's Rules and Regulations*, 104 F.C.C.2d 958, 964-965, ¶¶ 3-6 (1986) ("*Computer III*").

Thus, their arguments that other protections would not suffice are nothing more than self-serving speculation

A. Important Changes Since Adoption of the OI&M Rule Have Eliminated Any Incentives to Discriminate or Misallocate Costs.

Both the marketplace and the Commission's rules have changed in critical respects since the Commission adopted the OI&M restriction, and those changes — together with the heavy costs of the restriction discussed in Part III, below — mandate elimination of the rule. The long distance carriers claim that there are "no changed circumstances" that justify reconsideration of the restriction.[10] But that defies belief: to begin with, both intra- and intermodal competition have developed since 1996 to the extent that the services of wireless carriers, Voice over Internet Protocol (VoIP) and cable telephony providers, facilities-based CLECs, and competitive access providers present active and serious local service competition. The BOCs have experienced a decline in demand for their local exchange and exchange access services that would make it not only impossible, but also competitively irrational, for them to misallocate additional costs to these services [11]

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[10] *See* MCI Comments, at 6; AT&T Comments, at 24; Comments of Sprint Corporation, Dec 10, 2003, at 2 ("Sprint Comments")

[11] *See, e.g* , Industry Analysis & Technology Division, WCB, FCC, *Telephone Competition: Status as of December 31, 2002* at Table 1 (June 2003) (ILEC end-user switched access lines have declined from a peak of 181.3 million in 1999 to 162.7 million in 2002); S. Flannery, *et al.*, Morgan Stanley, *2Q03 Trend Tracker. Casualties of War* at 19 (Aug. 19, 2003) (BellSouth, SBC and Verizon saw access MOUs decline 8 percent and 7.8 percent in the first and second quarters of 2003, respectively.), FCC, *Statistics of Communications Common Carriers* (rel Nov 10, 2003) at Table 2.6 (2002/2003 Preliminary ed.) (reporting 459 billion local calls in 2002), FCC, *Statistics of Communications Common Carriers* at Table 2.6 (2001/2002 ed.) (reporting 515 billion local calls in 2001, from 2001 to 2002, total local calls declined nearly 11 percent)

Indeed, the BOCs increasingly face serious threats from wireless carriers and cable telephony, including cable companies that now have rolled out VoIP. As Chairman Powell has observed, "much of the most significant competition in voice . . . has come from wireless phone service."[12/] Analysts have estimated that wireless traffic has displaced 30 percent of total wireline minutes,[13/] a trend that is expected only to accelerate.[14/] Lehman Brothers estimates that 8 million households have wireless phones but no landlines, and that 25 million more households are candidates for giving up wireline connections.[15/] By 2006, a Yankee Group study predicts, U.S. mobile subscribers will increase by 50 percent and will "dominate personal calling and

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12/ *Competition Issues in the Telecommunications Industry: Hearings Before the Senate Comm. on Commerce, Science, and Transportation*, 108th Cong. (2003) (prepared statement of Michael K. Powell, Chairman, FCC). *See also* Memorandum Opinion and Order, *Application by SBC Communications Inc., Nevada Bell Tel. Co., and Southwestern Bell Communications Services, Inc., for Authorization to Provide In-Region, InterLATA Services in Nevada*, 18 FCC Rcd 7196, 7204 ¶ 15 (2003) (finding that broadband PCS "represents an actual commercial alternative to [a BOC] for residential telephone exchange services.").

13/ *See FCC Reports Wireless Sub Growth is Leveling, Mobile is on Rise*, Communications Daily, Vol. 23, Issue 124 (June 27, 2003).

14/ Phil Cusick *et al.*, Bear, Stearns & Co., Inc., Industry Report, *Non-Public Operators Steal the Show . . . Again*, Investext Rpt. No. 7397790, at *7 (May 20, 2003) ("For the next year we are looking for [wireless] minute-usage growth of 16% per user, and 26% overall as more customers are added and more telecom minutes are migrated to wireless."); *3G Rollouts Inch Along, But Kagan Research Indicates Wireless Minutes Roaring Ahead, Set to Dominate Telecom Landscape by 2005*, Bus. Wire (Apr. 27, 2001) (landline minutes growing in "low single digits"), *see also* Phil Cusick et al., Bear, Stearns & Co., Inc., *Wireless Services – Searching for the Catalysts*, Investext Rpt. No. 7393872, at *31 (May 13, 2003) (expecting "increasing minute usage as the wireline-wireless cannibalization continues.").

15/ Christine Nuzum, *Update: Americans Cut Their Wires, Threatening Carriers*, Dow Jones News Serv. (Sept. 24, 2003). Lehman Brothers further estimates that wireless accounted for 30 percent of total telecom sector revenue in 2002, up from 5 percent in 1996. *See FCC Reports Wireless Sub Growth is Leveling, Mobile is on Rise*, Communications Daily, Vol. 23, Issue 124 (June 27, 2003). Merrill Lynch reports that between 1997 and 2002, wireless revenue has grown by 154 percent and predicts that this trend will continue and result in a decline in wireline revenues of 14 percent by 2002 to 2005. Merrill Lynch, Telecom Services, *Unraveling Revenues, Telecommunications*, at 3 (Nov. 20, 2003).

severely cannibalize landline minutes of use."[16] And investment analysts uniformly agree that VoIP services, which cable operators are aggressively deploying throughout the country,[17] will increasingly erode the BOCs' business. AOL Time Warner announced only recently that it had reached a deal under which it would provide VoIP service on a *nationwide* basis and be in "most, if not all, of its markets" by the end of 2004;[18] all other major cable companies similarly have now introduced commercial VoIP service or have trials in process.[19] Cable companies' rollout

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16/ News Release, Yankee Group, *Consumers Abandon Landlines and Increase Mobile Call Volumes, Creating Strong Growth in the Wireless Market, Reports Yankee Group* (Sept. 16, 2002). LECs are also losing traffic as a result of the growth of e-mail and instant messaging services. It is estimated that consumers in the United States are sending approximately 3.2 billion e-mail messages and approximately 1 billion instant messages per day. *See* T. Shinkle, *Time for a New Look at E-mail Management*, Computer Technology Rev., at 48 (June 2001); *See* R Gann, *Fast Talking Instant Messaging Software*, Internet Magazine, at 140 (Jan. 1, 2001).

17/ *See* Alan Breznick, *Major MSOs Prepare for Full-Scale Rollouts of VoIP Service: Comcast and Cox Shift into Launch Mode. Joining Time Warner and Cablevision*, Cable Datacom News (Nov. 2003), *available at* http://www voip-news.com/mso.html (noting that Time Warner Cable, Cablevision Systems, Cox Communications and Comcast Corp., as well as many small cable operators, have all either already introduced commercial voice-over-IP services or are launching "soft" market rollouts or large market trials); Cox Digital Telephone, *Do we need another local phone service provider?*, *available at* http://www.cox.com/telephone/Frequently%20Asked%20Questions.asp (Over 350,000 customers have already switched to Cox's telephony service.) Cable companies, of course, are not the only providers offering VoIP service. For example, Vonage — a provider of exclusively VoIP services — provides service to customers throughout the country. Press Release, Vonage, *Vonage Completes 100 Million Calls Over its SIP Network* (Dec. 10, 2003)

18/ Matt Richtel, *Time Warner to Use Cable Lines to Add Phone to Internet Service*, N.Y. Times (Dec 9, 2003), *see also* Glenn Britt, Chairman & CEO, Time Warner Cable, Presentation at *UBS Warburg Media Conference* (Dec. 11, 2003) (presenting nationwide VoIP plan and describing VoIP as "the next big business opportunity").

19/ *See* Richtel, N Y. Times (Dec. 9, 2003); Breznick, Cable Datacom News (Nov. 2003). Cablevision has deployed cable telephony service throughout its New York and New Jersey service area *See* David P Willis, *Cable Calling*, Asbury Park Press (Nov. 23, 2003) *available at* http://www.app.com/app/story/0,21625,859803,00 html (Cablevision Systems now offers voice-over-IP services in New Jersey, New York, and Connecticut); *see also* Tom Rutledge, President Cable and Communication, Cablevision, Presentation at *UBS Warburg Media Conference* (Dec. 11, 2003) (presenting the company's rollout of VoIP in the New York area).

of these services has been described as "the largest risk to Bell fundamentals over the next 5 years," with analysts noting that "the impact on margins is increasingly evident today."[20] Goldman Sachs, for example, predicts that VoIP providers are likely to capture 20 percent to 30 percent of the residential voice market, "with serious share gains by 2005."[21] Meanwhile, BOCs also are losing exchange access business due to competition from competitive access providers.[22]

Although the Commission certainly was expecting that competition would flourish when it adopted the OI&M rule in 1996, it could not have foreseen the vigorous nature of the intra- and intermodal competition that has developed since then. In such a competitive market, Verizon and the other BOCs would be foolish to misallocate costs in an effort to raise prices — either to the local *or* the long distance services they offer. Rather, such intense competition imposes an extremely effective control over prices and ensures that no incentives for cost misallocation

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[20] John Hodulik, UBS Investment Research, *Cable Telephony Competition: Who Gets It?* at 1 (Aug. 7, 2003).

[21] Frank Governali et al., Goldman Sachs, *Telecom Services, Broadband—the pie is growing, the telco slice isn't*, at 2 (Dec. 10, 2003).

[22] *See, e.g.*, New Paradigm Resources Group, Inc., *CLEC Report 2003* at Ch. 3 - Table 8 (17th ed. 2003) (reporting that CLECs had $13 billion in revenue from switched local service and $9.9 billion in revenue from dedicated access and private line in 2002); Industry Analysis & Technology Division, WCB, FCC, *Telecommunications Industry Revenues 2001* at Tables 5 & 6 (rel. Mar. 20, 2003) (In 2001, CLECs had $4.4 billion in revenue from providing switched local service and $4.9 billion in revenue from local private line and special access services.); *see also* Industry Analysis & Technology Division, WCB, FCC, *Telephone Competition: Status as of December 31, 2002* at Table 1 (June 2003) (As of year-end 2002, CLECs had garnered 13.2 percent of all switched access lines nationwide.).

exist.[23/] Indeed, in response to these developments, the ILECs have engaged in serious cost-cutting measures, including recent major reductions in their numbers of employees.[24/]

Several years of price cap regulation have also eliminated incentives for cost misallocation.[25/] Price caps sever the link between carriers' costs and regulated rates, and thereby eliminate the opportunity to recover costs or losses from any remaining "monopoly" customers.[26/] As economists have concluded, "breaking [the] link between costs and prices" provides "superior incentive properties."[27/] Price caps give BOCs an incentive to be cost efficient and *minimize*, not inflate, costs.[28/] AT&T's claim to the contrary is unpersuasive. Not

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23/ As noted in Verizon's opening comments, the Act's various non-discrimination safeguards also would make it competitively self-defeating for a BOC to overcharge or undercharge its affiliate for OI&M services: if it overcharged the affiliate, no other competitor would take the BOC's expensive OI&M service, and the BOC's affiliate would be disadvantaged by higher operating costs for its long distance services, if it *undercharged*, all competitors would have that advantage and the BOC's local company would bear the burden of subsidizing *all* its competitors.

24/ Verizon, for example, reported just last month that more than 21,000 of its employees accepted an early retirement offer. *See Verizon Announces Estimated Charges and Ongoing Savings From Voluntary Separation Plan* (Dec. 9, 2003), *available at* http.//investor.verizon com/news/ VZ/2003-12-09_X603687.html.

25/ While AT&T suggests that if price caps standing alone were sufficient, Congress would not have imposed the separate affiliate requirement at all, this begs the question: the incentives produced by price caps do *not* stand alone, but are in *addition* to the forces of competition.

26/ *See* Tardiff Decl ¶ 24 (explaining that price caps are an improvement over traditional regulation because they eliminate the incentive of regulated firms to engage in predation or otherwise cross-subsidize competitive services)

27/ Dennis L. Weisman, *Is There 'Hope' for Price Cap Regulation?*, Information Economics and Policy, Sept 2002, at 354

28/ *See* W. Kip Viscusi, John M. Vernon, and Joseph E. Harrington, Jr., *Economics of Regulation and Antitrust, Second Edition*, (Cambridge, MA: The MIT Press, 1995), at 386, *see also* Robert Crandall and Leonard Waverman, *Talk Is Cheap: The Promise of Regulatory Reform* surprisingly, AT&T can cite support only from years *before* price caps were widely substituted for traditional cost-plus, rate base/rate of return regulation at the state and federal levels. *See* AT&T Comments, at 23-24.

Indeed, when it adopted the OI&M restriction, the Commission itself acknowledged that a carrier could have an incentive to misallocate costs only if it were subject to rate of return regulation, a price caps structure with sharing, or a price caps scheme that adjusts the x-factor periodically based on changes in industry productivity, or if the revenues it is allowed to recover are based on costs recorded in regulated books of account. *See Non-Accounting Safeguards Order* at 21911-12 ¶ 10. But such conditions have largely been eliminated for the BOCs in almost all jurisdictions — a significant change that the long distance carriers ignore. Moreover, since the OI&M rule was adopted, the Commission eliminated sharing from price caps and adopted the CALLS plan, which links the x-factor exclusively to the consumer price index, and ends the need for a cost-supported SLC. AT&T's assertion that expiration of CALLS could reverse those incentives, *see* AT&T Comments, at 25, is absurd. The BOCs have pursued elimination of cost-based regulation and a transition to market-based rates.

B. Existing Regulations Prevent Any Possible Cost Misallocation and Discrimination.

Several years of experience with section 272 requirements demonstrate that safeguards other than the OI&M rule are more than adequate to prevent any remaining possibility that the BOCs would seek to engage in cost misallocation or discrimination. That experience disproves the long distance carriers' contention that the OI&M rule must be preserved because it is the *only* regulatory safeguard against discrimination and cost misallocation. *See* AT&T Comments, at

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in North American Telecommunications at 108-109 (1995) (finding that "[price cap] regulation provides the correct incentives for cost minimization")

22-23; MCI Comments, at 4-7; Sprint Comments, at 2-3. Nor is there any merit to the long distance carriers' claim that the OI&M rule is the only cost-efficient safeguard. Although the Commission previously predicted that sharing of services would require burdensome and costly regulation and monitoring of BOC activities, *see Non-Accounting Safeguards Order* at 21984 ¶ 163 (citing *BOC Separations Order*), such regulation has in fact been proven to be far less intrusive and costly than the OI&M restriction The long distance carriers merely speculate when they assert that if the OI&M restriction were eliminated, the Commission would have to devote considerably more resources to monitoring the sharing of these services between BOCs and their section 272 affiliates. *See* AT&T Comments, at 26-27; MCI Comments, at 6-7. The only support the long distance carriers can cite are the Commission's statements in 1997 in the *Non-Accounting Safeguards Order* Those statements were made in a vacuum, before the Commission had significant experience monitoring such sharing of services.

Indeed, there is no substantive difference between the safeguards that, in absence of the OI&M restriction, would be required to monitor the sharing of those services and the safeguards that already govern administrative service BOCs share with their section 272 affiliates. The long distance carriers fail to acknowledge the comprehensive reach of these regulations. The affiliate transaction rules would require any OI&M transactions between BOCs and their section 272 affiliates to be conducted on an arm's-length basis, reduced to writing, and made available for public inspection. *See* 47 U.S.C. § 272(b)(5). Section 272 affiliates would continue to be required to maintain separate books and be subject to audits. *Id.* §§ 272(b)(2), 272(d). And the long distance carriers are wrong in claiming that the Commission has not fully employed its auditing powers, *see* AT&T Comments, at 27; MCI Comments, at 7. The Commission conducts biennial audits of both the BOCs' cost allocation manuals as well as their compliance with section 272 Verizon has already undergone two section 272 audits under increasingly stringent procedures, and both demonstrated Verizon's material compliance with the applicable regulations.[29]

The long distance carriers' claims that competition would be impaired if sharing of OI&M services were permitted therefore are entirely misplaced.[30] *See* AT&T Comments, at 28-29, MCI Comments, at 7. Indeed, as the Commission's experience eliminating similar regulations in other markets has demonstrated, competition will undoubtedly continue to flourish in the local and long distance markets if the OI&M restriction is eliminated, and in the broadband market, where cable companies and the long distance carriers are dominant, competition should be permitted to develop further and more freely. In the intraLATA toll market, interLATA corridor market, information services market, customer premises equipment market, and inside wiring maintenance services market, the BOCs have competed for years on an integrated basis and are allowed to share OI&M services. Contrary to the long distance carriers' claims, competition has not suffered Prices have fallen and output has increased – an outcome opposite of what would be expected if BOCs were exercising market power. In fact, the BOCs

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[29] *See* Comments of the Verizon Telephone and Long Distance Companies, Dec. 10, 2003, at 12 n 16 ("Verizon Comments"). Likewise, AT&T and MCI fail to acknowledge the host of additional rules that the BOCs would be subject to in the absence of the OI&M restriction, including the requirement of section 201 that the BOCs offer just and reasonable rates, the section 202 prohibition on discrimination, and the requirements of sections 251 and 272 that BOCs make their networks and services available to competitors at reasonable rates. *See* 47 U.S.C §§ 201, 202, 251(c), 272(c), 272(e).

[30] The long distance carriers' suggestion that Congress itself recognized that the OI&M restriction is "critical in preventing discrimination and cost misallocation," AT&T Comments, at 22, is counterfactual. Had Congress thought the protection "critical," it would have specifically required it, as it did in section 274 Instead, Congress relied on a nondiscrimination requirement in section 272(c) that prohibits BOCs from discriminating between their section 272 affiliates and other companies in the provision of services *See* 27 U S.C. §§ 272(c)(1), 272(e).

combined have less than 40 percent of the nationwide intraLATA toll market for residential direct dial minutes, despite having started with 100 percent of this market.[31/] The BOCs have an even smaller share – approximately 15 percent -- of the of the markets for voice messaging,[32/] CPE, and inside wiring, *see* Tardiff Decl. ¶ 10, and a still smaller share of the information services market.[33/] In each of these markets, the nonstructural safeguards that would apply if the OI&M restriction were eliminated have proven to be more than adequate to prevent discrimination and facilitate competition

The long distance carriers do not risk discrimination in any event, because they do not depend on BOC facilities and services. AT&T, MCI, and Sprint, the largest long distance carriers, own switches that they use for both local and long distance services, and they are not subject to any "bottleneck" that might once have existed in this market.[34/] They of course are free to share OI&M services between their affiliates and profit from the significant efficiencies that such sharing offers. Their arguments that the BOCs would thus be the *only* competitors that

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31/ *See* Industry Analysis & Technology Division, WCB, FCC, *Statistics of the Long Distance Telecommunications Industry* at Table 14 (May 2003); *see also* Tardiff Decl. ¶¶ 8-11.

32/ After reviewing the substantial record in a proceeding concerning voice messaging services, the Maryland Public Service Commission staff concluded that "Verizon cannot have market power in voicemail services." Brief of Maryland Pub. Serv. Comm'n at 6, *Complaint of CloseCall America Inc. v. Verizon Maryland Inc* , Case No. 8927 (Md. Pub. Serv. Comm'n Sept. 26, 2003).

33/ *See, e g.*, A Goldman, *Top U.S ISP Subscribers: First Quarter 2003 Analysis*, ISP-Planet (July 31, 2003), available at http://www.isp-planet.com/research/rankings/2003/usa_ insight _ q22003.html (The BOCs have 5.9 million dial-up subscribers combined, out of over 51 million dial-up subscribers nationwide, for a market share of 11.4% market share.).

34/ *UNE Fact Report 2002, CC Docket Nos. 01-338 (Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers); 96-98 (Implementation of the Local Competition Provisions in the Telecommunications Act of 1996); 98-147 Deployment of Wireline Services Offering Advanced Telecommunications Capability)* (filed Apr. 12, 2002), II-1 ("UNE Fact Report").

could share such services between local and long distance affiliates are therefore simply wrong *See* AT&T Comments, at 22-23; MCI Comments, at 4-5. Far from being potential victims of discrimination, the long distance carriers merely seek to maintain this burdensome restriction on the BOCs for their own benefit.

III. The Long Distance Carriers Do Not Seriously Dispute That the OI&M Restriction Seriously Hampers the BOCs' Ability To Provide Broadband Services.

The long distance carriers fail to grapple at all with one key harm to the public interest imposed by the OI&M restriction: the imposition of duplicative costs and serious inefficiencies in the provision of broadband services, which impede investment and unfairly burden the BOCs as compared to their more established broadband competitors. BOCs are relative newcomers to the robustly competitive broadband market, with only limited market share.[35/] Cable companies dominate the mass market segment of the broadband market,[36/] and the large long distance

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35/ *See, e.g.*, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, *Review of Section 251 Obligations of Incumbent Local Exchange Carriers*, CC Docket Nos. 01-338, 96-98, 98-147, FCC 03-36 ¶ 293 (rel. Aug. 21, 2003) ("*Triennial Review Order*"); *USTA v. FCC*, 290 F.3d 415, 428-29 (D.C. Cir. 2002), cert. denied 123 S.Ct. 1571 (2003); *Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, 14 FCC Rcd 2398, 2404 ¶ 12 (1999).

36/ Cable modem service, which now serves 14.5 million users, maintains a 64% share of the high speed market. *CableFax* Databriefs, Nov. 17, 2003. *See also Triennial Review Order* ¶ 262 (noting that "nationally, cable modem service is the most widely used" mass market broadband service and "the gap between cable modem and ADSL subscribership continues to widen") (*citing* High Speed Services December 2002 Report (noting that cable modem service is provided over nine million lines, or approximately 57% of all high-speed lines)).

carriers dominate the large business segment, providing some two-thirds of all Frame and ATM services.[37]

While AT&T argues that the BOCs have never shown that the OI&M rule impedes competition, *see* AT&T Comments, at 28, the effect of the rule is obvious. In the broadband and enterprise markets, only the BOCs are subject to the burdensome OI&M restriction; their competitors are free to offer the same services, and to capitalize on all the economies that integrated broadband service offers, without incurring the costs of redundant personnel and systems. At a time when the Commission is encouraging the deployment of broadband to serve the interests of all consumers across the nation, the OI&M rule imposes unnecessary costs that *increase* BOCs' costs of providing broadband while providing no compensatory benefits.

Although BOCs offer combined packages of services that are as streamlined as possible, consumers are deprived of the increased efficiencies that could be gained if they could provide more fully integrated solutions. The Commission has recognized that a key objective of the 1996 Act was "to give service providers the freedom to develop a wide array of service packages and allow consumers to select what best suits their needs."[38] *See Non-Accounting Safeguards Order* at 21915 ¶ 18 And section 706(a) creates an "affirmative obligation" for the FCC to "encourage the deployment . . . of advanced telecommunications capability to all Americans " 47 U.S.C. § 157 note. Yet the OI&M restriction works in precisely the opposite direction.

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[37] AT&T, WorldCom, and Sprint are the largest providers of both Frame Relay and ATM services; together they control more than two-thirds of the nationwide market for these services. *See* UNE Fact Report, at II-24.

[38] The commitment to encourage the deployment of broadband services led the Commission appropriately to eliminate the unbundling obligations for incumbent LECs' broadband facilities and new fiber. *Triennial Review Order* ¶¶ 272-73, 288.

The long distance carriers also are unable to do anything but quibble with the sheer dollar cost imposed by the OI&M restrictions, and their arguments, advanced in the forbearance proceedings, are unpersuasive The fact remains that Verizon's long distance affiliate has incurred **[BEGIN PROPRIETARY]** **[END PROPRIETARY]** in costs caused by the OI&M rule between 1998-2002, and will incur another **[BEGIN PROPRIETARY]** **[END PROPRIETARY]** from 2003 through 2006 if the restriction is not eliminated *See* June 4, 2003 Ex Parte, at Attach. 4; Verizon Petition for Forbearance, CC Docket No. 96-149, Howard Decl (filed Aug. 5, 2002) at 3 ¶ 5 ("Verizon Forbearance Petition") Verizon estimates that if the OI&M restriction were eliminated, it could avoid $183 million in OI&M-related costs over the next few years. *See* June 4, 2003 Ex Parte, Attach. 3 at 6. SBC showed that it incurs annual OI&M costs of $77 million for its data services affiliate alone *See* SBC Comments, at 2, n.5. AT&T's reliance on Qwest's statement that it has yet to incur substantial OI&M costs, *see* AT&T Comments, at 28, proves nothing at all. It is hardly surprising that Qwest has not yet incurred OI&M costs on par with those incurred by Verizon and SBC, given that it was the last ILEC to receive section 271 approval in any of its states. As Qwest pointed out, and AT&T ignored, it will undoubtedly incur significant costs due to the OI&M restriction going forward.[39]

Verizon has already refuted all of AT&T's efforts to undermine the specifics of Verizon's cost showing. For example, contrary to AT&T's claim that Verizon assumed the BOC would charge its affiliate improperly low prices for OI&M services, *see* AT&T Comments, at 28, n 17, Verizon has shown that the BOC would in fact be required to charge the "prevailing market

[39] *See* Qwest's Petition for Forbearance. CC Docket No. 96-149, at 6-7 (filed Oct. 3, 2003).

price" standard for affiliate transactions under section 32.27(c) of the Commission's rules.[40] Verizon also has demonstrated that the Commission would have adequate assurance that Verizon would properly track the costs for OI&M services if sharing were allowed *See* Oct. 27, 2003 Verizon Ex Parte at 2 For years, Verizon has tracked costs for nonregulated services such as inside wire maintenance according to the cost allocation procedures described in its Cost Allocation Manual ("CAM"), which is audited on a biennial basis, and there is no reason why cost tracking for OI&M services would operate differently. *See id.* In addition, there is nothing to AT&T's claim that Verizon's estimates of cost savings are either inaccurate or demonstrate that the BOCs have excess spare capacity As Verizon explained, it estimated that it could save about 30 percent of the section 272 affiliate's workforce expenses because the larger local exchange company, with its greater scope of services and customers, could handle the long distance affiliate's additional work with fewer additional employees The long distance affiliate would otherwise have to retain a devoted employee or contract with outside vendors for even a minimal amount of work *See id* at 3, *see also* June 4, 2003 Verizon Ex Parte, at Attach. 3 at 3.

But in any event, AT&T clearly could never show -- even if all of its arguments were accepted — that the BOCs incur *no* costs in complying with the requirement to employ redundant OI&M personnel and systems. Even if the costs Verizon and SBC have demonstrated are reduced by half or even more, the "cost benefit analysis" that the Commission found originally justified the restriction now clearly favors its elimination. the fact is, no competitive benefits justify these costs at all.

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[40] *See* Letter from Ann D. Berkowitz, Project Manager, Verizon, to Marlene Dortch, Secretary, FCC. CC Docket No 96-149, at 2 (filed Oct. 27, 2003) ("Oct. 27, 2003 Verizon Ex Parte").

CONCLUSION

For all the reasons set forth above, the Commission should eliminate the OI&M rule.

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December 22, 2003

CERTIFICATE OF SERVICE

I, Mary Beth Caswell, do hereby certify that true and accurate copies of the foregoing, COMMENTS OF THE VERIZON TELEPHONE AND LONG DISTANCE COMPANIES, were served by the method indicated this 22nd day of December, 2003, upon:

Marlene H Dortch, *original plus 1 copy of the Confidential Version, 2 copies of the Public Version, by hand delivery*
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